TXU Response to the Australian Consumer & Competition Commission
NSW and ACT Transmission Network Revenue Caps – TransGrid 2004/05- 2008/09

I. Introduction

TXU supports the principles of the regulation of transmission revenues under chapter 6 of the National Electricity Code (the Code) on the basis that the ACCC continues to develop its Draft Regulatory Principles for the Regulation of Transmission Revenues (DRP). In doing so, it supports a regulatory regime that develops more consistency, predictability, transparency and accountability in its decision making process reducing the threat of regulatory error. In this environment, TXU believes that the ACCC will improve its credibility with investors in the energy industry as processes become more clearly defined and improved.

TXU's position on the ACCC's Draft Decision regarding the NSW & ACT Transmission Network Revenue Caps – TransGrid 2004/05 – 2008/09 is to make five key points, specifically:

- TXU supports the ACCC's approach to allow TransGrid to re-submit its capital expenditure on an "ex-ante" basis once it has finalised its approach to setting capital expenditure as part of its review of the Draft Regulatory Principles (DRP) for Transmission revenues.
- TXU supports the ACCC's approach to applying a higher standard of prudency assessment to large projects, the actual cost of which has turned out to be materially higher than its forecast costs.
- TXU supports TransGrid's decision to exclude the SNI project from its capital expenditure forecasts on the basis that the investment does not pass the regulatory test as applied by the Supreme Court of Victoria.
- With respect to providing for a higher forecast opex allowance to achieve higher reliability, this should only be done in return for operational success as measured by market based performance standards.
- TXU supports TransGrid's requirement for improved clarity around how the ACCC will treat 'efficiency gains' on opex for the new regulatory term.

II. Key Issues

2.1 The ACCC's approach to setting capital expenditure

TXU supports the ACCC's approach to allow TransGrid to re-submit its capital expenditure on an "ex-ante" basis once it has finalised its approach to setting capital expenditure as part of its review of the Draft Regulatory Principles (DRP) for transmission revenues.

TXU believes that capital expenditure set under the new methodology established as part of the DRP will reduce the threat of regulatory risk whilst incentivising TNSPs to efficiently manage capital expenditure. The capital expenditure benchmark set under the new methodology captured in the DRP will set capital expenditure on an "ex-ante" basis and abolish the threat of re-optimisation. TXU supports the new methodology for setting capital expenditure benchmarks because:

- The approach to setting capital expenditure benchmarks has been established in a transparent manner after lengthy consultation with the appropriate stakeholders. The ACCC has undertaken a detailed comparison of the "old" and "new" approaches to setting capital expenditure benchmarks before drawing any conclusions about their merit.

- The approach to setting capital expenditure benchmarks, setting a firm cap on an "ex-ante basis", has been established after an open communication process with stakeholders. This will enhance predictability and consistency in the approach to setting capital expenditure benchmarks, reducing the threat of regulatory error. TXU supports this approach because the methodology has been established after sufficiently fair, accessible and open influence.

- The "ex-ante" approach established by the ACCC represents a much more efficient approach to setting the capital expenditure benchmark for a TNSP when compared to the previous methodology. This will result in more efficient outcomes.

TXU believes that the previous methodology applied by the ACCC in setting capital expenditure benchmarks for TNSPs did not provide appropriate incentives for efficient investment. In the past, TNSPs were able to over spend capital expenditure relative to the forecast benchmarks and expect to "roll-in" the expenditure in addition to the benchmark into the regulated asset base. The threat of re-optimisation was seldom used by the ACCC, probably because it required an intrusive regulatory regime and therefore did not form a genuine behavioural driver. Under the proposed approach, in the event a TNSP invested in a higher level than the capex forecast in the cap, the additional investment would not be included in its regulated asset base. TXU supports this proposed approach subject to appropriate "off ramps". [1]

2.2 Applying a higher standard of prudency assessment to large projects

TXU supports the ACCC's approach to applying a higher standard of prudency assessment to large projects the actual cost of which has turned out to be materially higher than its forecast costs. This is evidenced by its submission to the DRP, where it stated that for large augmentation investments (i.e. investments greater than $20M) TXU has recommended a review of the regulatory test by the ACCC with public consultation, before the investment takes place.

TXU supports the prudency assessment of the Metro-Grid project on the basis described by the ACCC. The difficulty this "ex-post" review creates for TransGrid underlies the benefits as articulated by TXU in its DRP submission for a high level of "ex-ante" scrutiny in projects valued greater than $20M. Had this occurred in this case, then the TNSP would not be facing the threat of re-optimisation.

2.3 The exclusion of SNI from TransGrid's capital expenditure forecasts

TXU supports TransGrid's decision to exclude the SNI project from its capital expenditure forecasts on the basis the investment does not pass the regulatory test as applied by the Supreme Court of Victoria. However, what is unclear, is TransGrid's intention regarding the portion of SNI that was held to pass the regulatory test

[1] Please see TXU submission to the Draft Statement of Principles for the regulation of Transmission Revenues – Capital Expenditure Framework for the "off ramp" model proposed by TXU in regulating transmission revenues.

2.4 <u>TXU rejects Macquarie Generation's submission to the draft decision that requests a higher opex allowance for a higher reliability level on the basis that this improves competition in the generation market as irrelevant.</u>

Macquarie generation believes that a reduction in both opex and capex spent on the transmission system in the next regulatory term would have large impacts on the cost of generation if the reliability failed on the transmission system. This would have an impact on the market and the cost of generation.

TXU believes that an increased opex allowance, in the absence of output incentives, would not lead to increased network reliability. It would be preferable to provide market based incentive measures to drive behaviour. In general, the behavioural change required involves a very minor level of operational expenditure, in the order of + or – 1% of regulated revenues proposed as subject to performance measures.

The objectives of the regulatory framework under chapter 6 of the Code are clearly identified. Sect 6.2.2 of the Code that states

> *" The transmission revenue regulatory regime to be administered by the ACCC pursuant to the Code must seek to achieve the following outcomes:*
>
> *(e) An environment that fosters efficient operating and maintenance practices within the transmission system.*

An inflated opex allowance that allows for a much higher level of reliability on the basis that it will promote competition in generation will lead to an inefficient level of opex to service the network over the regulatory term. The promotion of competition in upstream generation is not a key consideration for the ACCC in the course of regulating natural monopoly revenues under the Code. This task is addressed in other key areas of the regulatory framework.

<u>2.5 TXU supports TransGrid's requirement for improved clarity around how the ACCC will treat 'efficiency gains' on opex for the new regulatory term.</u>

TXU believes the ACCC's arrangement in not providing an efficiency carry over in opex as part of this review is inconsistent with its position in the DRP. The ACCC provides for an efficiency carryover on opex in the DRP. However, as part of this review, the ACCC states on p.3 of its Draft Decision that

> *"No arrangement was made for an efficiency carry over mechanism and there was no scope for an ex-post review of actual opex."*

The ACCC supports the use of a glide path on opex on the basis that this provides <u>improved incentives to the regulatory regime. On p. 95 of the DRP it specifically states that</u>

> <u>*" Glide pathing operating and maintenance expenditures will enhance the incentive for cost saving capital expenditures and this is perceived by the Commission to be desirable.*</u>

If the ACCC believes that glide pathing opex improves incentives for efficient expenditure, then it should

(i) Provide an efficiency carry over on opex with a glide path.
(ii) Provide a clear carry over mechanism on opex as part of the DRP and apply it in the regulation of transmission revenues

III. Conclusion

In summary the 5 key areas of support that TXU has regarding the NSW & ACT Transmission Network Revenue Caps – TransGrid 2004/05 – 2008/09 decision are

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- TXU supports TransGrid's requirement for improved clarity around how the ACCC will treat 'efficiency gains' on opex for the new regulatory term.

Yours Sincerely

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